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PUBLIC UTILITIES  
COMMISSION

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BEFORE THE PUBLIC UTILITIES COMMISSION  
OF THE STATE OF HAWAII

In the Matter of the Application of )  
HAWAIIAN ELECTRIC COMPANY, INC. )  
For Approval of Rate Increases and Revised )  
Rate Schedules and Rules. )

DOCKET NO. 2008-0083

DIVISION OF CONSUMER ADVOCACY'S  
REPLY BRIEF

AND

CERTIFICATE OF SERVICE

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**DIVISION OF CONSUMER ADVOCACY'S**  
**REPLY BRIEF**

**I. INTRODUCTION.**

The Consumer Advocate presented in its Opening Brief ("CAOB")<sup>1</sup> a recommendation that the Commission enter its Decision and Order in this Docket consistent with the unanimous Stipulated Settlement Letter ("Settlement") among the Parties<sup>2</sup> that was dated and filed May 15, 2009. The revenue recommendation was therefore that the Commission's Final Order should authorize a permanent revenue increase not exceeding \$79.8 million, which is the amount set forth in the Statement of Probable Entitlement filed by HECO based upon the Settlement on May 18.<sup>3</sup> In its Interim Decision and Order dated July 2, 2009 ("ID&O"), the Commission raised a

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<sup>1</sup> The CAOB was filed on January 5, 2010.

<sup>2</sup> The Division of Consumer Advocacy, Department of Commerce and Consumer Affairs ("Consumer Advocate"), Hawaiian Electric Company, Inc. ("HECO or Company") and the Department of Defense ("DOD") ("collectively referred to as the "Parties")

<sup>3</sup> The May 18, 2009, Statement of Probable Entitlement was based upon a 10.5 percent ROE and excluded the additional informational advertising costs that were issues to be litigated in this Docket.

number of additional concerns and issues for hearing that reduced the authorized HECO interim increase to \$61.1 million.<sup>4</sup>

The HECO Opening Brief ("HECO-OB") summarized the evidence and explained the Company's advocacy on these additional issues, as well as on the Return on Equity ("ROE") and Informational Advertising issues that the Settling Parties had intended to litigate. The Consumer Advocate recognizes HECO's responsibility to respond and provide support for the Company's position on the additional issues and thus, the Consumer Advocate did not address each of the additional issues in the CAOB. The HECO-OB also indicates that the Company is willing to reduce the Settlement revenue requirement for certain items.<sup>5</sup> HECO provided supporting documentation to the Consumer Advocate for the listed reductions in its Opening Brief and engaged in discussions to explain these revisions.

Based upon the limited review that was possible under the circumstances,<sup>6</sup> the Consumer Advocate does not object to the further reductions to the Settlement revenue requirement that are now presented as appropriate by HECO. HECO has provided factual support for these changes and the Consumer Advocate has no basis to find that these further reductions to the Settlement revenue requirement are unreasonable. Furthermore, these modest further reductions in revenue requirement are consistent with the CAOB recommendations for a revenue increase not exceeding the amounts set

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<sup>4</sup> In its July 8, 2009 filing, HECO submitted revised schedules resulting from the ID&O supportive of the lower interim increase that was compliant with the ID&O.

<sup>5</sup> HECO-OB, pages 8-10.

<sup>6</sup> During the week of January 18, HECO provided the Parties with spreadsheet analyses supportive of the additional adjustments that contained references into the HECO-OB and/or the record in this Docket and participated in a conference call to explain and discuss the revisions.

forth in the Settlement. After the HECO-recommended further reductions, the permanent revenue increase approved by the Commission should not exceed \$63.7 million, as set forth in the following table of revenue requirement results:<sup>7</sup>

	Revenue Requirement		Interim
	No	Decoupling	10.5% ROE
	Decoupling		
HECO ROE >	11% ROE	10.75% ROE	for
CA ROE >	10% ROE	9.5% ROE	Comparison
HECO Position with New Adjustments	\$ 83,248	\$ 80,193	\$ 77,137
Less: CA Position on Advertising	(849)	(850)	(852)
Subtotal	82,399	79,343	\$ 76,285
Less: CA Position -ROE	(12,569)	(15,628)	
[10.0%/ 9.5%]			
CA Position with New Adjustments	\$ 69,830	\$ 63,715	

This table starts with the HECO revenue requirement that is expected to be summarized in the Company's Reply Brief, based upon information and supporting calculations for HECO's new ratemaking adjustments that were conceded at hearings. This updated information was provided by HECO shortly before Reply Briefs were due, so the Consumer Advocate's review was somewhat limited, but sufficient to conclude that the new adjustments should be made. Because HECO's position assumes it will prevail regarding disputed informational advertising, it is necessary to remove the revenue requirement value of this issue to determine the Consumer Advocate's position.<sup>8</sup> A further reduction is needed to reduce HECO's proposed ROE of 11.0% or 10.75%,

<sup>7</sup> This amount assumes an approved ROE of 9.5 percent to coincide with the Consumer Advocate position if decoupling is approved for use by HECO, as well as approval of the Consumer Advocate position on the advertising issue, adoption of the further reductions offered in the HECO-OB and reversal of all of the disallowances contained within the Commission's ID&O. If the Commission's Final Order does not reverse the disallowances set forth in the ID&O, the revenue requirement would be reduced accordingly.

<sup>8</sup> The revenue requirement value of the Consumer Advocate's \$774 thousand expense adjustment to advertising is increased by revenue taxes that must be collected on HECO expense recoveries, as well as working cash impacts associated with such recoveries.

depending upon the decoupling outcome, to the lower 10.0% and 9.5%, respectively, that is being recommended by the Consumer Advocate, to yield the "CA Position with New Adjustments" shown in this table.<sup>9</sup> Amounts in the last column are provided to show how the \$79.8 million revenue requirement set forth in the settlement for interim purposes (at 10.5% ROE) would be modified by HECO's new adjustments.

The balance of the Consumer Advocate's Reply Brief will respond to arguments made in the HECO-OB regarding the two issues which were not settled among the Parties, and will also provide clarification comments in response to certain other topics raised in the HECO-OB.

## **II. RETURN ON EQUITY.**

As noted in the CAOB, the only remaining cost of capital issues among the Parties after the Settlement Agreement was reached were the cost of common equity and the modification to the cost of long-term debt to reflect the lower cost of the 2009 Revenue Bond issue. The Consumer Advocate notes, however, that another issue in the instant proceeding relating to the determination of cost of capital is the Commission's determination of the possible impact of various cost recovery mechanisms that already exist (e.g., ECAC) and might be approved (e.g., decoupling).

In its CAOB, the Consumer Advocate noted that the 5.81% cost of long-term debt in the Settlement Agreement did not reflect the lower cost of the July 2009 Revenue

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It is not clear that HECO has made the adjustments necessary to reduce the long-term cost of debt to reflect the actual cost rate. Since HECO witness, Ms. Sekimura, acknowledged (TR. 1070-1071) that the cost of debt reflected in HECO-R-2003 should be lowered to reflect the actual cost, there should be no objection to this, but it is not readily evident that the change was made in HECO's updated revenue requirement calculations.

Bonds. The actual cost rate was 6.50% for the July 2009 Revenue Bonds, whereas HECO had used 7.00% as the projected rate used to calculate the 5.81% rate. The Consumer Advocate notes that while HECO has identified a number of additional adjustments that could be made to the revenue requirements to reflect more updated information (see section I of this reply brief), HECO did not discuss in its HECO-OB the need to update the data to reflect the July 2009 rate of 6.50% and HECO still has not corrected its cost of long-term debt to reflect this actual lower cost (see page 188 of HECO's OB). The Consumer Advocate contends that this amount should be corrected.

While the Company agreed to a cost of common equity of 10.5% for purposes of establishing a minimum amount of revenue requirements to which it believed it was entitled, the Company contended that a higher cost of capital was appropriate when determining the revenue requirements to be approved in the Commission's final decision and order in the instant proceeding. In its HECO-OB, HECO continues to maintain that the Commission should authorize a cost of common equity of 10.75% with the adoption of the Energy Agreement cost recovery mechanisms and 11.0% absent the adoption of these mechanisms (HECO OB at 176). The basis for this claim is the cost of capital testimony of HECO witness Morin, as cited in the OB of HECO (p. 176). As set forth in the Consumer Advocate's supplemental testimony and the CAOB, the Company's assertion that the Commission should authorize a cost of common equity of 10.75% with the adoption of the various cost recovery mechanisms and 11.0% without the adoption of those mechanisms should not be adopted by the Commission. HECO's assertions overstate a reasonable cost of common equity that as has been

discussed in the Direct and Supplemental Testimonies of CA witness Parcell as well as in the CAOB (p. 19-20).

For instance, as set forth on pages 177 – 182 of HECO-OB, HECO continues to assert that the Company's cost of equity should not be reduced at this time since the "utility industry has experienced a steady escalation of risk over the past ten years." Notwithstanding this assertion, the Consumer Advocate contends that HECO's position is contradicted by its own testimony. As was noted in the CAOB (p. 20-21), if the utility industry has experienced a steady escalation of risk, one would assume that a utility company would request and seek increasing cost of common equity in rate proceedings. However, HECO's requested returns on equity in the past several cases, as well as the updates in the current case, show a decline in the claimed ROE. This inconsistency illustrates that HECO's assertion is without merit.

The Consumer Advocate notes that HECO's OB cites (pages 208-233) the "risks," both business and financial, that the Company faces. The Company notes the following "risks" in its HECO-OB: Regulation, Markets, Operations, Competitiveness, Management, Imputed Debt for PPAs and Operating Leases, Purchased Power, Imputed Debt to PPAs. The Consumer Advocate further notes that most, if not all, of these risks are not new to HECO at this time. Thus, HECO's attempt to identify these risks should not be perceived as support for any significant change in the Company's circumstances in comparison to its prior rate proceedings. The Consumer Advocate acknowledges that the Energy Agreement represents an ambitious plan to pursue a course of action that will help Hawaii's transition to reduce its reliance on imported fossil



fuels. However, included within the Energy Agreement are certain mechanisms that offset much of those identified risks.

As discussed in the testimony of Mr. Parcell (CA-T-4, p 20-23), HECO currently enjoys and/or may soon have access to a number of regulatory mechanisms that are not all generally available to many utilities. These include: the review of major capital additions between rate proceedings to determine the appropriateness of those projects as a result of General Order No. 7; the ECAC clause; the IRP/DSM clause; the recently approved CEIS/REIP surcharge; the requested PPA adjustment; the Pension/OPEB tracking mechanism; and the requested decoupling mechanism consisting of both a Revenue Balancing Account ("RBA") and Rate Adjustment Mechanism ("RAM"). Each of these mechanisms reduce the risk that HECO might face and, if approved by the Commission as proposed by the Consumer Advocate in Docket No. 2008-0274, the decoupling RBA and RAM mechanisms will greatly reduce the risk that HECO faces with respect to revenue collection. If approved as set forth in the joint agreement between HECO and the Consumer Advocate in Docket No. 2008-0274, the decoupling mechanisms would essentially insulate HECO from changes in usage and would allow HECO to recover increases in the cost of service on a timely basis. This clearly reduces the Company's risk significantly, even with the commitments made in the Energy Agreement in mind.

HECO's OB attempts to minimize the impact of these mechanisms, claiming that some of them come with conditions (HECO OB at 233-234). The Consumer Advocate contends that none of the conditions preclude HECO from recovering prudently incurred costs. Thus, as long as HECO is confident that its future decisions reflect prudent and

reasonable actions, HECO's exposure to risk related to these mechanisms will be nominal. Nevertheless, regardless of any arguments about what risks are associated with the conditions that have been attached to the currently approved and possible cost recovery mechanisms, the fact remains that few other utilities have access to such an array of mechanisms. In this regard, it is noteworthy that Hawaii is one of only nine states that Value Line assigns an "Above Average Regulatory Climate" (CA-T-4, p 20). HECO also enjoys other advantages, such as the availability of Revenue Bonds issued through the State of Hawaii Department of Budget and Finance. This is also not cited by HECO as a risk-reducing factor, but as compared to other electric utilities that must seek debt financing through the financial market, the ability of HECO to rely on either the retail financial markets or to use Revenue Bonds reduces the risk that HECO faces.

### III. INFORMATIONAL ADVERTISING.

The Consumer Advocate has no dispute, in this proceeding, with HECO's assertion that the Company has an ongoing need to incur and recover costs for informational advertising. The dispute is focused on the amount which is just and reasonable. The HECO-OB asserts that the Company's requested test year allowance of \$1.1 million in non-labor costs for information advertising is reasonable and appropriate and is only about one-third the amount actually spent by the Company on customer informational advertising in each of the prior two years.<sup>10</sup> This claim is misleading, because these expenses include past HECO advertising costs to promote the Residential Customer Energy Awareness ("RCEA") program and its other DSM

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<sup>10</sup> HECO-OB, page 84.

programs.<sup>11</sup> The proper comparison should not refer to past amounts of HECO's total advertising spending including RCEA and DSM related advertising. Rather, the test year funding for advertising should be compared to the informational advertising HECO has needed in the recent past without the DSM and RCEA programs because of the transfer of energy efficiency DSM responsibilities to the Public Benefits Fund Administrator ("PBF Administrator") and because of the Commission's prior Order to discontinue the RCEA program.<sup>12</sup>

The Consumer Advocate's recommended level of informational advertising expense for base rate recovery excludes the RCEA-like energy conservation awareness messages that the Commission has ordered HECO to discontinue. The issue before the Commission at this time is whether, when the Commission issued its Order in Docket No. 2007-0341, it was serious about terminating HECO's spending on the RCEA Program. Given the Commission's denial of HECO's specified requested continuation of RCEA funding and assuming no intent by the Commission to allow HECO to re-establish RCEA or the like, as a base rate-funded program due to the transition of the HECO Companies' DSM programs to the PBF Administrator, the Consumer Advocate has recommended a lower alternative level of utility expensed advertising. The CA recommendation is based upon the average amounts actually required to be spent by HECO in categories of informational advertising other than conservation awareness.<sup>13</sup>

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<sup>11</sup> HECO-RT-10A, page 11.

<sup>12</sup> See, Commission Order dated November 14, 2008, Docket No. 2007-0341 at 1, 9, 11. The Commission set forth its detailed explanation for denying HECO's request to continue the RCEA program.

<sup>13</sup> CA-T-1, page 115.

HECO has admitted that this historical spending has been adequate to meet its obligations other than for building general energy conservation awareness, such as the need to inform customers about general electrical safety, Rule 16 information on rights for submitting damage claims and outage prevention education.<sup>14</sup>

Utility advertising spending by HECO outside of DSM and RCEA has been at the following levels, compared with HECO's test year proposal:

Year	Utility Advertising
2005	\$ 554,350
2006	\$ 187,813
2007	\$ 642,010
2008	\$ 194,703
HECO's Proposal	\$1,148,000

The amounts from 2006 through 2008 of this table were averaged and used to develop the Consumer Advocate's recommended level of utility advertising of \$342,000, as shown in Exhibit CA-101, Schedule C-21.<sup>15</sup>

HECO also expresses its belief that the PBF Administrator's planned spending on advertising will be inadequate and "not likely to be anywhere near as extensive as what the Company has conducted in the recent past to increase awareness amongst its

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<sup>14</sup> Tr. 935 - 937.

<sup>15</sup> Id. page 117.

customers.”<sup>16</sup> Because of this suggested problem, HECO desires higher advertising recoveries through its base rates to “complement” the efforts of the PBF Administrator.<sup>17</sup> On this point, the Consumer Advocate is concerned about mixing the resources and advertising messages of HECO and the PBF Administrator, particularly where the PBF Administrator is contractually responsible for achieving specified levels of conservation performance relative to established targets and will receive performance bonuses based upon such performance.<sup>18</sup> It is unreasonable to burden ratepayers with the costs of funding the PBF programs, including the advertising and other promotional costs incurred by the PBF administrator, and then also increase HECO rates for vaguely defined “complementary” advertising. Rather than embedding substantial additional advertising funds within HECO’s revenue requirement, the utility should be required to submit specific plans and budgets for the advertising required to support defined DSM and/or RCEA-like campaign objectives, and subject such spending and cost-effectiveness to ongoing regulatory reporting and oversight similar to that required of the PBF Administrator.

Another argument raised by HECO is that its past informational advertising campaign has “achieved demonstrated results,” as illustrated in the Ward Research Report dated September 2008.<sup>19</sup> This is the same Report that was submitted by HECO

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<sup>16</sup> HECO-OB, page 85.

<sup>17</sup> Id. page 84.

<sup>18</sup> CA Hearing Exhibit 1 is a copy of the contract between the PBF Administrator and the Commission specifying the funding for planned program activities, including advertising and performance bonus terms.

<sup>19</sup> HECO-OB, page 87. Exhibit HECO-R-10A01.

in support of RCEA Program effectiveness and was referenced by the Commission in Docket No. 2007-0341 when the Commission refused to authorize continuation of HECO's RCEA Program. There is nothing within the Ward Report to support HECO's contention that more expansive HECO advertising is effective or necessary for the Company to meet the required goals under Renewable Portfolio Standards or for targeted reductions in Greenhouse Gas emissions.

HECO's allegation that, "The planned advertising helps carry out the State's objectives by increasing awareness of the importance of energy conservation from the standpoint of consumer savings and environmental benefits" remains an unproven assertion that is not supported by the Ward Report or any other authoritative documentation in the record.<sup>20</sup> The Consumer Advocate recognizes that the PBF Administrator desires to establish its own "brand" to support the marketing of its DSM programs and to support long-term consumer conservation attitudes.<sup>21</sup> What is less clear is that ratepayers should also be required to fund more than \$1 million for mass media TV, radio and print advertising placement to promote the HECO brand and HECO messaging that is redundant to the PBF Administrator's efforts and costs.

Much of what HECO offers in support of its proposed level of informational advertising raises many questions, some of which might or should be appropriately addressed before requiring HECO's customers to bear the burden of increased

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<sup>20</sup> Id. page 82.

<sup>21</sup> HECO-OB, page 85. Also, this raises a different issue that should be addressed in another forum. The issue relates to whether the PBF Administrator, as currently selected and/or as may be replaced in the future, should be allowed to create a specific "brand" or "identity" as opposed to creating a generic brand or identity. Thus, if or when the current PBF Administrator is replaced, the customers will not be burdened with costs to re-establish a new brand or identity for future successors.

advertising costs. For instance, even if the Commission were inclined to support the concept of utility advertising complementing the PBF Administrator's efforts and costs, there should be a concerted effort to plan the nature of such complementary efforts before seeking to increase base rates to recover such costs. Such planning could or maybe should occur within whatever process develops from Docket No. 2009-0108, the Commission's investigation of proposed amendments to the framework for integrated resources planning.<sup>22</sup> Otherwise, as already explained, the Consumer Advocate is concerned that, in these current economic conditions, HECO's customers will be asked to bear costs for advertising efforts that may be redundant.

#### **IV. OTHER RESPONSIVE COMMENTS.**

##### **A. FOCUSED REGULATORY AUDITS IN TARGETED AREAS.**

The HECO-OB noted the Consumer Advocate's detailed list of proposed topics and procedures supporting recommended focused management audits that was offered and explained in the panel hearing on this topic. The HECO-OB downplays the need for and timeliness of such audits. Instead, HECO offered the following alternatives, which should be found unacceptable:

- The Company does a detailed review in a rate case and is proposing to have periodic rate cases in the Company's decoupling proposal.

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<sup>22</sup> It might be argued that waiting for a final decision and order in Docket No. 2009-0108 might adversely affect efforts to build customer awareness. Even if the final decision and order is not issued in Docket No. 2009-0108 in the immediate future, the Consumer Advocate contends that HECO and its affiliates can approach the PBF Administrator (or vice versa) and a joint plan can be developed and submitted to the Commission and the Consumer Advocate to ensure that duplicative efforts will not occur and that customers are not being asked to bear unnecessary costs through both base rates and through the PBF charge.

- HECO has in the past been subject to third-party operational audits of specific projects, processes or divisions, and provided copies of reports from these audits.
- The Company already filed detailed cost reports and is discussing a review of its capital project costing and estimation, presumably using CT-1 as an example.
- Regarding the CIS project cost, the Company will be looking at the cost of that throughout. The IT governance area, one of the key issues, was actually reviewed, and the Company has already taken steps to improve and change IT governance.<sup>23</sup>

These comments are notable for what they do not claim. HECO has not claimed that its cost over-runs on its CT-1 generating station, East Oahu Transmission Project ("EOTP") or Customer Information System ("CIS") projects are not worthy of careful and critical investigation to determine the prudence of total incurred costs, before ratepayers become responsible for the overruns in future rate cases. HECO has also not indicated any intent to seek less than its full amount of incurred costs for these projects in its future rate cases. HECO has not identified any independent audits of the prudence of such costs that will be conducted by the Commission or the Consumer Advocate, to be completed in time for presentation within its next rate case. These are important omissions indicative of HECO's lack of interest in being required to explain and defend

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<sup>23</sup> HECO-OB, pages 325-326.



the prudence of its decisions and the cost-effectiveness of its results in these large and problematic projects.

The Commission's ID&O identified an important regulatory mechanism, the management audit, which can help to ensure that ratepayers are being provided reliable utility services at the lowest reasonable and prudent cost. HECO has offered no valid objection in its HECO-OB to the completion of timely and focused investigations of cost prudence in the areas of concern identified by the Consumer Advocate in the panel hearing.<sup>24</sup> If initiated quickly and managed carefully, prudence audits of these projects will produce critically important information that will be relevant in the next HELCO rate case. The Consumer Advocate notes that while HECO contends that it has conducted and been subject to a number of third-party reviews, these past reviews have apparently not contributed to HECO's ability to mitigate the issues and concerns that are being raised with respect to the CIP CT-1 and Customer Information System ("CIS") projects. Obliging HECO to fund a Commission-managed contract to conduct such independent audits, with assurance that all reasonable costs incurred by HECO for such efforts will be recoverable from ratepayers, should remove any basis for valid objection to such an effort.

With regard to HECO's troubled CIS project, the Settlement in this Docket recognized that the substantial CIS software development costs initially included in HECO's asserted test year revenue requirement were later removed when the CIS project became the subject of formal vendor dispute with breach of contract claims asserted by HECO. In the Settlement in this Docket, the substantial concerns of the

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<sup>24</sup> Hearing Exhibit CA-4 summarized the regulatory audit topics and procedures that were recommended by CA witness Mr. Brosch in the panel hearing.

Consumer Advocate and DOD raised in connection with the CIS cost overruns and delays were recited, concluding with the statement, "HECO agrees that the Commission should formally review the CIS cost amounts submitted for recovery by HECO after the CIS project is completed."<sup>25</sup> There is, based upon this language, no dispute that formal review of the prudence of CIS project costs is appropriate. This formal CIS project review clearly cannot be concluded until, "...after the CIS project is completed", however any CIS prudence audit must be initiated before project completion in order for audit results to be available within HECO's next rate case. This timing problem is illustrative of the challenges of integrating cost prudence audit activity within periodic rate cases. However, these problems must be managed and overcome in order to protect ratepayers from unreasonable utility rates reflective of imprudently incurred costs.

The Consumer Advocate can appreciate that the Company's position may be based on the desire to avoid the additional work and scrutiny that might be associated with the prospect of management audits. If, however, the management audits are properly focused and designed, the Consumer Advocate contends that the management audits should be welcomed by the Company. If HECO contends that its actions and decisions have been prudent, an independent audit guided by the Commission will provide more weight and credibility in comparison to any unsubstantiated assertions that HECO might offer. Further, while HECO's suggested alternatives might be useful in terms of improving HECO's internal procedures to mitigate the possibility of similar future troubles resulting from capital and/or information

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<sup>25</sup> Stipulated Settlement Letter, Exhibit 1, pages 25-28.

technology projects, HECO's alternatives to address the need of assessing the prudence of the identified specific projects are sorely lacking.

There is simply inadequate time or resources within the context of future rate cases to conduct a thorough and carefully documented investigation of complex major construction or software projects at the same time all normal rate case issues must be developed and presented for Commission deliberation.<sup>26</sup> Therefore, the Consumer Advocate requests that the Commission direct HECO to immediately conduct at least three prudence investigation audits mentioned herein, for the CIS, EOTP and CT-1 projects, for completion within the next HECO rate case, using the procedures recommended by the Consumer Advocate in the panel hearing on this topic.

## **B. ELLIPSE 6 UPGRADE COSTS.**

In its Opening Brief (at 69-70), HECO addressed the Ellipse 6 Upgrade project, including the decision to defer the project from 2009 to 2011. In discussing the Company's willingness to reflect an additional downward adjustment<sup>27</sup> to test year A&G expense below the amount included in the negotiated settlement, HECO also indicated that it would not oppose normalizing the cost of a software upgrade, under certain conditions, and explained that normalization was not proposed "for ratemaking

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<sup>26</sup> The Consumer Advocate contends that it is for this very reason that the Commission has its General Order No. 7, paragraph 2.3.g.2, which allows the review of major capital projects to occur outside of a rate case. In this fashion, issues associated with the proposed project and any cost overruns can be addressed outside of a rate proceeding. Subsequently, the results of any findings from the review of the project can be reflected in rates in the next rate proceeding following the completion of the Commission's review of the project and its final cost.

<sup>27</sup> Reduction of (\$362,000) in Account 921 for Ellipse 6 software costs and (\$825,000) in Account 923020 for Ellipse 6 Outside Services. Opening Brief at 70.

purposes because of the previous method for determining test year expense estimates related to costs for the Ellipse system."<sup>28</sup>

In its response to PUC-IR-167, HECO explained why the 2009 rate case forecast did not reflect a normalization of the cost of the Ellipse upgrade citing to the positions of the Consumer Advocate in HECO's 2005 (Docket No. 04-0113) and 2007 (Docket No. 2006-0387) test year rate cases. With respect to the 2005 rate case, HECO accurately noted that the Company had proposed to include an estimate for the Ellipse upgrade in the test year forecast and that the Consumer Advocate opposed inclusion of costs in the 2005 forecast that were not expected to be incurred until 2007. In other words, HECO sought to pre-collect post-test year costs of a future software upgrade from ratepayers.<sup>29</sup>

The Consumer Advocate does not concur with the normalization process advocated by HECO in their response to CA-IR-167 or in its Opening Brief (at 69-70). The Consumer Advocate did not oppose inclusion of the Ellipse 6 upgrade costs in the pending 2009 test year forecast because the upgrade, previously expected in 2007, was expected to be finally implemented in 2009. Subsequent to the filing of the Consumer Advocate's direct testimony and the settlement agreement negotiated between the parties, HECO informed the Commission of the project's further deferral to 2011. Similar to its position in HECO's 2005 test year rate case, the Consumer Advocate cannot support the advance collection of software upgrade costs, particularly for a

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<sup>28</sup> See PUC-IR-167. Opening Brief at 69.

<sup>29</sup> See PUC-IR-167 and CA-T-2 (Docket No. 04-0013) at 39-42.

project that that appears to have been anticipated as imminent for six years (2005 vs. 2011).

Moreover, the fact that the next Ellipse upgrade (i.e., that HECO sought to include in the 2005 forecast) have now been again deferred from 2009 to 2011 further supports the Consumer Advocate's original opposition to the Company's pre-collection proposal in the 2005 rate case. Had some "normalization" approach been allowed in the 2005 (or the 2007) test year rate case, the Consumer Advocate can only envision the complex reconciliation calculations that would be required in the 2011 rate case, assuming the upgrade does occur in 2011, to ensure that ratepayers do not bear the cost of that next upgrade more than once (i.e., once through pre-collection starting in 2005 and again by inclusion in the 2011 rate case forecast).

HECO has not cited to any prefiled evidence sponsoring or supporting the normalization of the Ellipse 6 Upgrade costs in the pending rate case. Such a late proposal should be rejected by the Commission since the Parties (i.e., the Consumer Advocate and the Department of Defense) have had no opportunity to submit discovery, analyze or otherwise respond, other than in Reply Brief.

With regard to HECO's proposal to reduce O&M expenses by \$1,187,000 (Opening Brief at 70) as a result of deferring the Ellipse Upgrade project to 2011, the Consumer Advocate does not object to such an adjustment that better matches cost recovery with cost incurrence, consistent with the Consumer Advocate's comments on HECO's additional expense reductions as further discussed herein.

### **C. REIP/CEI SURCHARGE.**

In its Opening Brief, the Company acknowledges that the Commission recently issued its Decision and Order in Docket No. 2007-0416, approving a Renewable Energy Infrastructure Project / Clean Energy Initiative Surcharge mechanism ("REIP/CEI Surcharge") that provides for the recovery of specified project costs between rate case test years. HECO notes that the use of this new mechanism is subject to a number of stringent requirements as set forth in the Commission's Order. HECO also states that the REIP/CEI surcharge would be used to recover costs that would normally be expensed in the year incurred and to recover costs stranded by clean energy initiatives, subject to the Commission's prior approval.<sup>30</sup> At this juncture, the Consumer Advocate wishes to reiterate its concerns regarding any proposed recovery of HECO employees' labor or benefits costs through this surcharge mechanism.

In CA-T-1, the regulatory issues and problems with selective expedited recovery of specific types of utility costs are discussed in substantial detail.<sup>31</sup> Recognizing that the utilization of an REIP/CEI surcharge mechanism was already agreed upon by parties to the HCEI Agreement and in settlement of the REIP matter in Docket No. 2007-0008, Mr. Brosch explained in his testimony that the mechanism be "subject to very carefully applied definitional restrictions as well as an overall expense test to ensure that the total expenses incurred by HECO are no over-recovered through base rates." At this time, the Consumer Advocate would ask that the Commission adopt a finding that HECO's labor related costs are being recovered solely through base rates

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<sup>30</sup> HECO-OB, page 247.

<sup>31</sup> CA-T-1, pages 18-37.

and will not be recoverable through any future REIP/CEI surcharges that may be requested or authorized.<sup>32</sup> This restriction would not apply to capitalized costs for projects that can be separately considered for REIP/CEI surcharge recoveries, but would instead apply for the purpose of preventing duplicate or excessive recoveries of expensed labor and benefit costs through both base rates and surcharges.

In addition, while it does not affect the finding of reasonableness of revenue requirements in the instant proceeding, the Consumer Advocate is compelled to raise a question about HECO's apparent attempt to broaden the possible scope of uses for the REIP/CEI surcharge. While HECO contends in the HECO-OB that the REIP/CEI surcharge could be used to recover costs stranded by clean energy initiatives, it is not clear that this contention is supported. As set forth in the application and brief filed by the Company in Docket No. 2007-0416, the REIP/CEI surcharge was intended to "encourage the funding of [renewable infrastructure projects] and recover the costs for renewable energy infrastructure."<sup>33</sup> Upon review of the Commission's authorization of the REIP/CEI surcharge in its Decision and Order filed on December 30, 2009 in Docket No. 2007-0416, it is not clear that the Commission intended that stranded costs should be recoverable through the surcharge. In fact, the Consumer Advocate contends that the Commission's language clearly indicates that it expects to see only prospective projects that will contribute to Hawaii's efforts to meet the Clean Energy Initiative objectives, not capital costs already incurred that might be stranded.

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<sup>32</sup> Stipulated Settlement Letter, Exhibit 1, page 90.

<sup>33</sup> Legal Brief Regarding REIP Surcharge Issues of the Hawaiian Electric Companies, at 5.

## V. CONCLUSION.

In this reply brief, the Consumer Advocate has addressed the remaining issues that were outstanding from the Settlement and has also discussed the additional changes that the Company is proposing to make to reflect additional updates to the inputs that should be considered when determining the revenue requirements in the instant proceeding. In the CAO, the Consumer Advocate asserted that the Settlement reflected a reasonable result and that the Commission should not approve a revenue requirement no more than what was agreed to Settlement. Now, based on the review that was possible in the brief timeframe in which the Consumer Advocate's consultants were able to review the additional updates that HECO has proposed, the Consumer Advocate has calculated the possible revenue requirements that might result depending on the Commission's decision on the issues of informational advertising and the cost of common equity. Those estimates are set forth in the table in section I of this reply brief.


The Consumer Advocate recommends that the Commission reject the Company's request for an increased informational advertising since the Company has not adequately justified the prudence of having uncoordinated efforts by the Company and the PBF Administrator. Further, the Consumer Advocate recommends that the Commission should adopt either the 9.5 or 10 percent cost of common equity depending on the likely outcome of the Commission's deliberations on certain cost recovery mechanisms related to the Energy Agreement based on the support offered by the Consumer Advocate's witness. Finally, while it will not affect the determination of the revenue requirements in the instant proceeding, the Consumer Advocate supports the Commission's interest in management audits, if designed and focused appropriately



to produce information that will be useful to the Commission and the Company. Assuming that the Commission is so inclined, the Consumer Advocate recommends that, at a minimum, the suggested audits should focus on the CIP CT-1, CIS and EOTP projects. The results of any such audits, as each is completed, should be expected to be included within the rate proceeding following the completion of the applicable audit, if the Company expects to request cost recovery of the overruns associated with these projects.

DATED: Honolulu, Hawaii, January 26, 2010.

Respectfully submitted,

By   
JON S. ITOMURA  
Attorney for the

DIVISION OF CONSUMER ADVOCACY

**CERTIFICATE OF SERVICE**

I hereby certify that a copy of the foregoing **DIVISION OF CONSUMER ADVOCACY'S REPLY BRIEF** was duly served upon the following parties, by personal service, hand delivery, and/or U.S. mail, postage prepaid, and properly addressed pursuant to HAR § 6-61-21(d).

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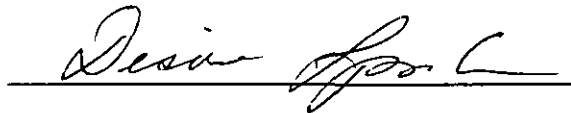
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A handwritten signature in cursive script, appearing to read "Desai", is written over a horizontal line.